

**COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
WASHINGTON, DC 20515**

April 13, 2023

The Honorable Daniel Werfel
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, D.C. 20224

Dear Commissioner Werfel,

On March 23, 2023, the Treasury Inspector General for Tax Administration (TIGTA) released a report outlining significant flaws in Internal Revenue Service (IRS) processes for measuring our nation's tax gap.¹ The latest IRS estimate indicates America's net tax gap has ballooned to over \$428 billion, but this figure is based on data from over seven years ago and fails to capture several sources of noncompliance, especially among wealthy taxpayers and corporations.²

TIGTA's investigation identified serious shortcomings in the methodology and data sources used to calculate several components of the tax gap. For instance, the IRS's nonfiling figure does not include corporate income taxes, excise taxes, income taxes of estates and trusts, unrelated business taxable income, or certain employment taxes. The underreporting figure, which makes up the bulk of the tax gap, does not include corporate income taxes filed on forms other than Form 1120 or Form 1120-A, unrelated business taxable income, certain employment taxes, and income taxes filed by international taxpayers.³ These omissions weaken the value of available data.

Developing an accurate tax gap estimate requires robust audit data. The National Bureau of Economic Research found that the random audits used to inform tax gap estimates were "not designed to estimate the tax gap for very high-income, high-wealth individuals."⁴ On April 13, 2021, your predecessor testified before the Senate Finance Committee that the tax gap estimate does not fully reflect certain sources of noncompliance that audits largely fail to capture, including foreign source income, pass-through income, virtual currency holdings, and offshore income.⁵

¹ Treasury Inspector General for Tax Administration, Actions Are Needed to Improve the Completeness (TIGTA), Development, and Review of IRS Tax Gap Estimates (March 13, 2023), <https://www.tigta.gov/sites/default/files/reports/2023-03/202310016fr.pdf>

² Internal Revenue Service, IRS updates tax gap estimates; new data points the way toward enhancing taxpayer service, compliance efforts (October 28, 2022), <https://www.irs.gov/newsroom/irs-updates-tax-gap-estimates-new-data-points-the-way-toward-enhancing-taxpayer-service-compliance-efforts>

³ TIGTA, Actions Are Needed to Improve the Completeness (TIGTA), Development, and Review of IRS Tax Gap Estimates (March 13, 2023)

⁴ National Bureau of Economic Research, Tax Evasion at the Top of the Income Distribution: Theory and Evidence (March 2021), https://www.nber.org/system/files/working_papers/w28542/w28542.pdf

⁵ Committee on Finance, The 2021 Filing Season and 21st Century IRS (April 13, 2021), <https://www.finance.senate.gov/hearings/the-2021-filing-season-and-21st-century-irs>

These glaring blind spots are routinely exploited by wealthy individuals and businesses to hide assets and shirk their responsibility as taxpayers.

On June 10, 2021, the Ways and Means Subcommittees on Oversight and Select Revenue Measures convened a joint hearing on the tax gap and improving tax administration.⁶ Deputy Commissioner Douglas O'Donnell told us that current tax gap figures are “not intended to represent an all-inclusive, current measure of global tax non-compliance” and characterized the published estimates as “outdated, under-inclusive, and based on limited types of detected information.”⁷

Thanks to essential funding provided by the Inflation Reduction Act (IRA), the IRS can finally prioritize closing the growing tax gap by ensuring wealthy tax scofflaws and big business tax cheats pay their fair share. In my letter to you on March 9, 2023, I emphasized the need for the IRS to overhaul its entire auditing regime.⁸ Increasing enforcement staff, prioritizing audits of wealthy taxpayers, and exploring methods to better identify noncompliance will help close the tax gap and provide more robust noncompliance data for tax gap estimates. I'm pleased that the IRA Strategic Operating Plan prioritizes closing the tax gap by focusing enforcement on high-dollar noncompliance.

However, we cannot move toward true tax fairness without transparent and comprehensive reporting on this deeply damaging gap. The IRA Strategic Operating Plan acknowledges that modern technology and enhanced analytics will improve the agency's understanding of “voluntary compliance by enhancing the timeliness, granularity and comprehensiveness of tax-gap measurement” but lacks specificity on carrying out this important objective.⁹ Accounting for the total scope of underreporting, underpayment, and nonfiling requires modernizing technology, adequately investing in staffing, and publishing comprehensive procedures.

You must direct resources toward technology modernization and additional staffing at the Office of Research, Applied Analytics and Statistics (RAAS) to support the tax gap estimation process. Deputy Commissioner O'Donnell testified that developments in “artificial intelligence, advanced data, and analytic strategies” have already begun to enhance the agency's ability to deploy its “limited enforcement-related resources” to identify noncompliance.¹⁰ You should allocate IRA funding toward staffing and upgrading the equipment, software, data analysis, and machine learning capabilities at RAAS to fully utilize emerging technologies to enable a more accurate and full accounting of taxpayer noncompliance.

The Internal Revenue Manual (IRM) does not include any substantive guidance on estimating the tax gap. RAAS primarily relies on precedent and institutional knowledge rather than

⁶ Committee on Ways and Means, Joint Hearing on “Minding the Tax Gap: Improving Tax Administration for the 21st Century” (June 10, 2021), <https://waysandmeans.house.gov/event/joint-hearing-on-minding-the-tax-gap-improving-tax-administration-for-the-21st-century/>

⁷ Committee on Ways and Means, Written Testimony of Douglass O'Donnell (June 10, 2021), https://waysandmeans.house.gov/wp-content/uploads/2021/06/ODonnell_Testimony.pdf

⁸ Committee on Ways and Means, Ways and Means Oversight Subcommittee Democrats Ask New IRS Leader For Detailed Plan to Address Broken Audit Process (March 10, 2023), https://pascrell.house.gov/uploadedfiles/2023_03_09_bp_et_al_letter_to_commissioner_werfel.pdf

⁹ Internal Revenue Service, Internal Revenue Service Inflation Reduction Act Strategic Operating Plan (April 6, 2023), <https://www.irs.gov/pub/irs-pdf/p3744.pdf>

¹⁰ Committee on Ways and Means, Written Testimony of Douglass O'Donnell (June 10, 2021)

written procedure. Tax gap estimates are also not subject to formal quality control or internal review prior to publication.¹¹ Such a process is vulnerable to staff turnover, inconsistently applied standards, and variations in methodology. The Government Accountability Office Green Book is clear that “documentation is required for the effective design, implementation, and operating effectiveness” of an agency’s internal control system.¹² Furthermore, issuing standardized guidance is necessary to promote transparency with the public and enable informed congressional oversight over the tax gap estimation process.

In sum, the methods used to estimate the tax gap are outdated and insufficient to meet the modern tax administration challenges posed in our global digital economy. Therefore, I request you provide a detailed plan to improve the tax gap estimation process by May 12, 2023, addressing at minimum the following:

1. Actions already taken to improve the tax gap estimation process in response to TIGTA’s investigation.
2. Expanding the tax gap estimation process to include components of the tax system currently absent in the nonfiling and underreporting figures, such as corporate income taxes, income taxes of estates and trusts, and certain employment taxes.
3. Accounting for certain sources of noncompliance not currently included in the tax gap estimate, such as foreign source income, pass-through income, virtual currency holdings, and offshore income.
4. Directing funding toward systems modernization and additional staffing at RAAS to ensure they have the personnel and technology necessary to develop an accurate estimation of taxpayer noncompliance.
5. Developing and publishing comprehensive and standardized guidelines in the IRM governing the tax gap estimation process to ensure consistency, transparency, and to facilitate informed congressional oversight.
6. Establishing a formal internal review process for tax gap estimates prior to publication.
7. Issuing timely tax gap estimates on an annual basis with updated data projecting current taxpayer noncompliance.

The American people must have faith that our tax system is administered lawfully, competently, and fairly. Closing the tax gap must be a priority for the IRS, and that starts with fully understanding how wealthy tax evaders are exploiting our system. Thank you for your timely response.

Sincerely,



Bill Pascrell, Jr., *Ranking Member*
Subcommittee on Oversight

¹¹ TIGTA, *Actions Are Needed to Improve the Completeness (TIGTA), Development, and Review of IRS Tax Gap Estimates* (March 13, 2023)

¹² Government Accountability Office, *Standards for Internal Control in the Federal Government* (September 2014), <https://www.gao.gov/assets/gao-14-704g.pdf>